Raising finance

FACTSHEET // MAY 2021

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1. Introduction

By the time you have reached this factsheet you should have developed your export strategy and should have a plan of action. But now we need to address the question of how, exactly, you are going to finance your export sales and any company growth that may result. During the export drive you will incur many costs, some large and some small. You may need to invest in additional capacity; you will almost certainly require additional working capital.

2. Financing growth

There are dangers in accepting substantial additional sales, whether domestic or foreign, without thinking through all the implications for cash flow. At this stage it is important to establish the steps you intend to take to ensure that you can find the necessary resources. Working capital requirements are likely to rise both because you are increasing your levels of sales and because foreign customers tend to take longer to pay – though factoring may improve your cash flow. You will need to determine, therefore:

- the level of finance required
- the type of financing required
- the projected timescale for financing

2.1 Calculating the extra costs

Think of your extra costs for two different requirements: initial development and operational. Developmental costs will be required, in effect, as an up-front investment. You will inevitably incur costs researching and breaking into new markets. Ideally, you should make an early assessment of the likely magnitude of those costs, perhaps with key stages and targets. As part of your research, you will be able to assess the likelihood of getting a suitable payback or return on that investment. And remember, that investment includes the costs of all the staff involved as well as the more obvious costs.

Once you have some success, and break into a new market, you may have further investments to make – in terms of additional equipment, staff and training – depending on

[1] This factsheet is based on material originally published in Exporting for the First Time by Graham Smith & Paul Sampson and edited by Colin Weatherspoon & David Irwin, copyright Project North East, 1996, and used with permission, and on material published by David Irwin on appraising business propositions.

your level of extra sales. You will certainly have extra direct costs – higher transport costs, more advertising and marketing, international trade fairs, agent's commission, higher insurance, more time to prepare documents, maybe special packaging, etc. Remember also that you need to have an accurate assessment of all your costs in order to price your products or services to ensure that you make a profit. In particular, though this is not an exclusive list, you may wish to think about the following:

- Underlying costs of providing the product to your domestic market
- Higher marketing costs
- Extra costs, for example, for changes to the product to meet local statutory or environmental requirements
- Changes to the product requested by your customers
- Additional quality assurance costs
- Different or additional packaging and export packing
- Transport and freight costs — including transport to a port or delivery point, shipping, air, road or rail freight and delivery to the buyer's premises. It may also involve freight forwarder's fees
- Clearance charges — including any licences, documentation required as well as handling charges, customs, import duty etc
- Extra costs of providing support or service following the sale
- Agent's commission
- Extra bank charges
- Costs of extra credit
- Credit insurance
- Insurance of cargo — essential for overseas transit and must cover goods through every stage of their journey. The responsibility is dictated by the INCOterm used in the sales contract..

Remember that costs will depend on circumstances: if you are selling to an international buying house, for example, then you will be unlikely to have to pay for freight and insurance. However, you may have less say in the final price you get for your products. The INCOterm you use may likewise determine whether you or your customer pays costs such as insurance and clearance charges. If you quote a price in the currency of your export market then you are left open to the vagaries of exchange rates. You should always specify a period for which the quotation is valid, especially if the currency is particularly volatile. On a positive note, you should bear in mind that some costs, such as initial promotional effort, changes in production methods, etc. may well lessen once you become more established in the market.

Figure 1: Typical costs to start trading

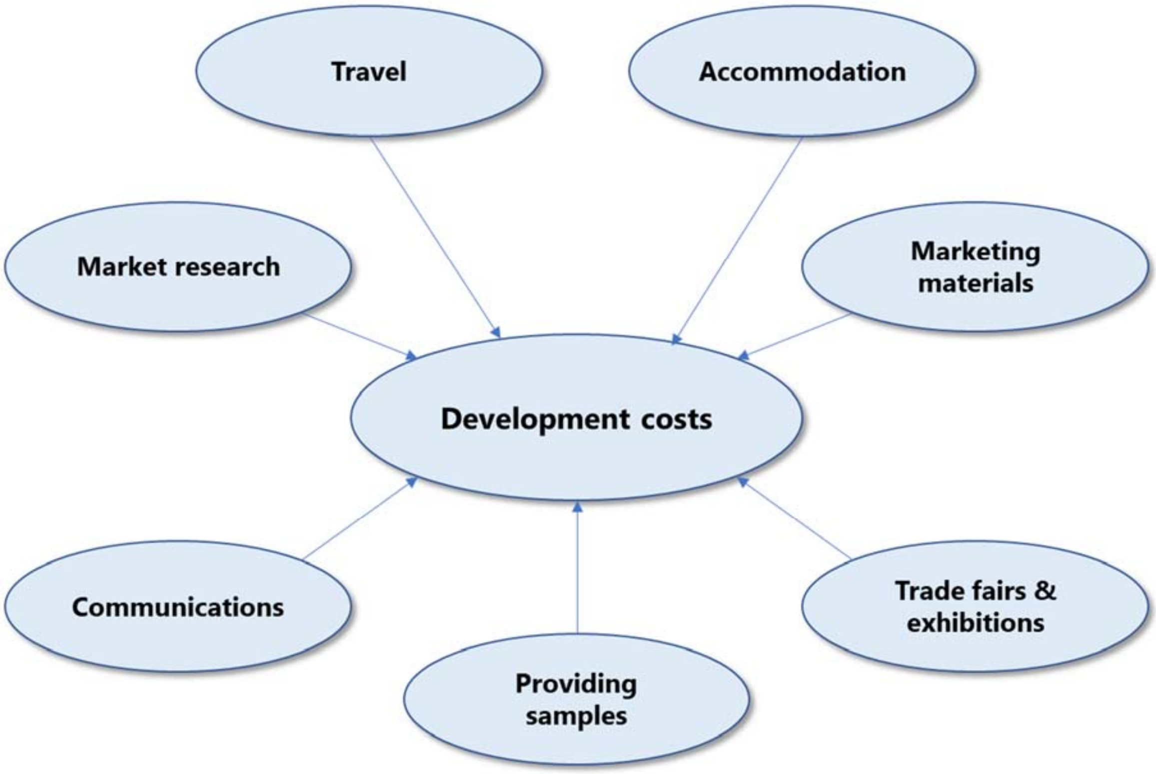

Figure 2: Typical costs to keep trading

Next steps

List what you think will be the key cost areas involved in implementing your export strategy. This could include cost of product development, travel, as well as any predicted sales.

3. Sources of finance

For any business, there are just three sources of finance: equity – introduced by you, partners or shareholders; loans – formally from the bank or informally from creditors; and, retained earnings – part of the profit which has been earned by and retained in the business. You are unlikely to be able to borrow money to cover your initial development costs so this will have to come by introducing more equity or, most likely, by using retained earnings.

Finance to cover working capital needs usually comes from an overdraft facility, trade creditors or retained earnings. Once you have secured an order and have spent the money required for production, adapting your product and getting it safely to the buyer, you are not guaranteed instant remuneration. Delays in payment are a common feature of exporting and these can hit your cashflows hard unless you have taken the risk of shortfall into account and have provided yourself with a buffer.

You may also need to think about medium and long term needs, such as new equipment, extra staff and even expansion of premises. Equipment, vehicles and machinery are usually financed through medium term loans, hire purchase or leasing. In the case of buildings and land, long term finance in the form of a mortgage or a long-term loan secured on the asset may be available.

3.1 Types of finance

Once your exports start to grow, it is likely that you will need a mixture of short and medium term funding. Depending on your specific requirements you may be able to raise this all from one source, or you may find that you have to package it from a number of sources.

You may find that grant aid is available – to help you undertake your initial market research, to go on trade missions, to attend trade fairs or exhibitions, etc. Talk to your adviser or trade association or the national export promotion advisory service.

Investment capital

Money required for investment – in equipment or premises for example – will primarily come by raising additional equity or by seeking medium or long term loan finance. Talk to your bank manager in the first instance. Then progress to other banks and financial institutions.

Working capital requirement

Customers will generally delay payments to you for as long as possible. With foreign customers you may find the delays become even longer. If you are still buying your raw materials from your normal suppliers, you will not be able to delay payment to them to compensate. And, as noted earlier, an increase in sales will also lead to an increased working capital requirement. Many businesses, though apparently profitable, fail because they neglected to watch their cash flow. So think carefully about your working capital requirements.

You may find the following calculation helpful:

CALCULATE WORKING CAPITAL REQUIRED

	Weeks
1. Determine average number of weeks raw material is held in stock eg	3
2. Deduct: credit period from suppliers	-4
3. Add: average number of weeks to produce goods or service	1
4. Add: average number of weeks finished goods are in stock	1
5. Add: average delivery time to customer	2
6. Add: average time customers take to pay	10
Total	13
Average weekly payments	$5,000
7. Multiply payments by weeks to give working capital required	$65,000

Remember that as sales rise, the working capital requirement will rise. If you have insufficient retailed earnings to cover this requirement, then you will need a bank overdraft or else to look at factoring.

Factoring and invoice discounting

You might choose to speed up payments for your supplies by factoring or invoice discounting. 'Factors' are often controlled by large banks. In return for a commission, the factor will keep checks upon the importers' credit facilities and will collect the money due. Although arrangements can be tailored to your particular needs, it largely involves turning over all payment responsibilities to the factor. One thing to keep in mind is that full factoring will decrease your contact with the buyer and this may be counter-productive to your long-term strategy.

Factoring is generally an expensive way of improving cash flow, but it can prove useful to the first time exporter as even the most reliable of businesses can find themselves in difficulty. It also allows you to offer an open account arrangement to encourage the buyer and, depending your specific factoring agreement, it may take away all the effort of chasing up the slow payers. As well as saving work, factoring will minimise risks associated with fluctuating exchange rates, as conversion is generally taken from the time when you present the documents to the factor.

With invoice discounting, you sell on to a discounter the face value of your invoices less their commission. You still retain control of your sales ledger, however, and you are still responsible for chasing slow payments – it might be beneficial in that your customers still send their payments to you direct and it is not therefore apparent to them that you discount the invoices.

Forfaiting is popular among exporters of capital goods, and is required to allow long-term credit to foreign customers. You, the exporter, will sell the total amount owed for the whole contract to the forfaiter, at a discounted price. You will receive the agreed amount, removing the worry of non-payment by the importer. The importer must have a reputable bank to guarantee payment, but the forfaiter will be responsible for collecting the money over the length of the credit. Forfaiting is similar to factoring and can be a complex process in terms of the maths and accounts involved. You will not receive the full amount of the sales contract, but the money that you do receive will be guaranteed.

If you use any of these methods, review the cost regularly. Compare it with the cost of having an overdraft or other ways of providing you with your working capital requirements.

As when using a confirming house or export agent to export your goods, payment may be guaranteed by these organisations. A non-recourse factor, for example, will provide protection against bad debts, though there will be an additional charge for this of around 1-3 per cent. You should read the small print carefully: some factors recharge you for invoices not settled within an agreed period which will give all the cashflow problems that factoring is intended to remove; they may also refuse to accept invoices to customers with a poor credit rating.

3.2 Seeking finance

In order to present your case for finance to potential funding sources you will need to prepare a convincing proposal and package of information. If the plan is simply for you and your colleagues you will only need to write down key elements such as

- a review of the marketplace in which the business export strategy proposes to operate including opportunities and threats;
- a summary of what needs to be done to exploit the opportunities and avoid the threats;
- a summary of the business's export marketing plan; and,
- the financial position of the business

There are also elements which should, ideally, be set out on paper. The first of these is a financial forecast, based on your targets, in order to provide an easy way to monitor progress. The second is your operational objectives and a few examples are provided below:

Operational objective	Performance measure	Target
Establish representation in target market	Geographical coverage	10,000 sq. m in 6 mth.
Improve quality assurance procedures	Rejections	Reduce to 7% in 6 mth.
Reduce order-to delivery-time	Avg. turnaround	1 week by year end
Improve flexibility of production process	Line change time	½ day by Oct.
Improve telesales capability	Call handling	up from 30/day to 60/day by Jan
Achieve export break-even within acceptable period	Export revenue	$8,000/mth. by July

3.3 A plan for others

If however, you need to raise finance from third parties then you will need to provide them with a written business plan. Your plan should demonstrate

- that the proposal is feasible - match the results of the market research to the targets for sales income
- that there is sufficient working capital - prepare a cash flow forecast and show that financial requirements are reasonable
- that the business is efficient - keep costs to the minimum
- that the business can supply its product or service to the specification and quality demanded by the customer on time and within budget.

Ideally, your plan will cover all the following sections:

i. Summary

Briefly describe the business and highlight the key objectives. Those people assessing the plan are likely to be very busy. A clear, simple outline can be the basis to help them think positively about the plan. Identify particular strengths and why the proposal should be supported.

ii. The business

The purpose and goals for the business should be stated. These should set out clearly what the business does and where it is going, particularly including its export objectives.

Describe the business and its history to date. How high is sales turnover? How profitable is it? What is its net worth? How does its performance compare with its competitors? (Provide detailed figures-profit & loss accounts and balance sheets in the appendices). How has the business been funded (loans, equity, grants)? What major achievements have been accomplished? Why do you want to start exporting? Explain whether the business is a company or a sole trader or a partnership. State if there are any distinguishing features. For example, if the business has achieved ISO 9000 then say so.

iii. The product or service

The product (or service) should be described in terms which the reader will understand. Remember that the 'product' is the first of the 4Ps. So the product description needs to explain why customers are going to want to buy the product. People rarely buy things just for the sake of owning them-what is the product going to do for the purchaser? Describe the features it provides and the benefits it confers on the people who will buy it. Are any of the features unique? Give details of patent, design registration or copyright if appropriate.

Are there competitive products? Why is the product going to be preferable to its competitors? What is the unique selling point?

iv. The market

Outline what research has been undertaken. What are the results of primary research (surveys, interviews, focus groups, test marketing, etc)? What are the results from reviewing secondary information (other people's research)? It may be helpful to include the information in tables or graphs; just include key information in this section. Detailed background can be included in the appendices.

What sales are forecast for the particular product(s) or service(s) covered by the business plan? Who are the target customers? Are these particular groups? Is it possible to concentrate on just one of those? It is often helpful to segment the market and aim at a precisely defined target audience.

What competition is there? Is there likely to be further competition in the future? What are the barriers to entry to this particular market?

v. Marketing plan

Earlier the plan defined a purpose for the business. This purpose can be translated into marketing objectives and goals which will support its realisation. The most common objectives are profitability, sales growth, diversification and market share improvement. Look back over earlier chapters explaining the 4Ps - product, price, position and promotion - and use those to describe your marketing plan.

vi. Management and organisation

Describe how you will manage your export sales and the impact it will have on your domestic business. Will you need to employ additional staff? What training may be required?

vii. Financial information

The objective of this section of the business plan is to show that the extra sales income will cover all the extra costs and generate sufficient extra profit to be worthwhile.

Demonstrate that the price has been checked against competitors. Is it too high? Remember, there is a premium for quality. Is it too low? Is there room to make more profit?

It may be helpful to include a break-even chart to show graphically how many units must be sold at a given price before the business starts to make a profit. The ideal business plan will include a cash flow forecast, a budgeted profit & loss and a forecast balance sheet. It is essential to show how much and when money will be needed by the business.

viii. Financial requirements

Indicate how much money is available from within the business. Will any extra be invested by the principal(s)? Give details of how much is sought from other sources and explain whether it is wanted as overdraft (for working capital), as term loans (for equipment for example) or as equity.

ix. Risk assessment

Once you have become established as an exporter you will wonder why you ever thought it so scary. However, exporting is undoubtedly more risky than sticking to domestic markets. It will help prospective financiers, therefore, if you can include your risk assessment – they will do their own – but it will be useful for them to see how you propose to mitigate those risks.

x. Appendices

The appendices can be used to include support information. This might include, for example, the results of market research to justify the figures quoted in the business plan. Include letters from prospective customers if they support the case and examples of questionnaires used.

The appendices might also include detailed curriculum vitae for the proprietor(s) and key staff, photographs of sample products, details of premises, etc.

If advertising or other promotional material is available, samples should also be included in an appendix.

4. Persuading the lender

Banks and other financial institutions will look at more than just your business plan. To remind themselves of all the aspects at which they do look, they have coined acronyms to remind themselves of the area to evaluate. These include PARSER (Purpose, Amount, Ratios (or some say Repayment), Security, Expediency, Repayment (some say Remuneration)) and CAMPARI (Character, Ability, Margin, Purpose, Amount, Repayment, Insurance, that is, security). So you need to do all you can to demonstrate that you are a very low risk – and that may include providing collateral. However, many countries also have export development banks, or ExIm banks, or export credit guarantee facilities which may be able to provide loans, or guarantee loans, without you having to find additional capital.

5. Conclusion

Funds will be needed in order to develop the various areas of your export drive. It may be the case that you have sufficient capital to fund the initial investments to get business established, but it is important that current business is not adversely affected by the export developments. Investing finance is an uncertain area for many small businesses, especially where resources are limited. However, a significant amount of advice is available and this issue can be approached sensibly within the wider context of your overall business needs. Think positive - exporting will require the investment of resources but the benefits of success will boost your business as a whole.

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